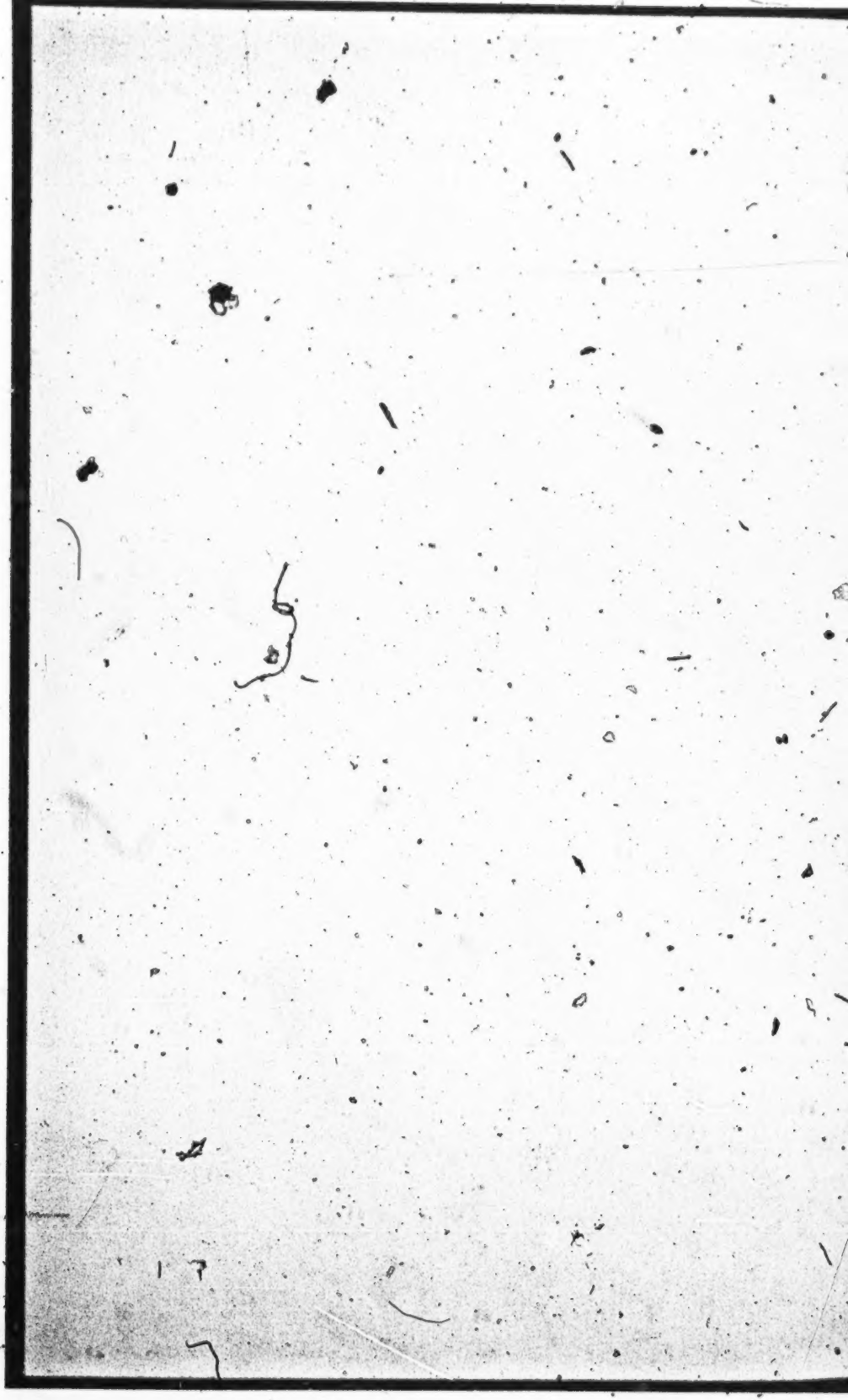


INDEX

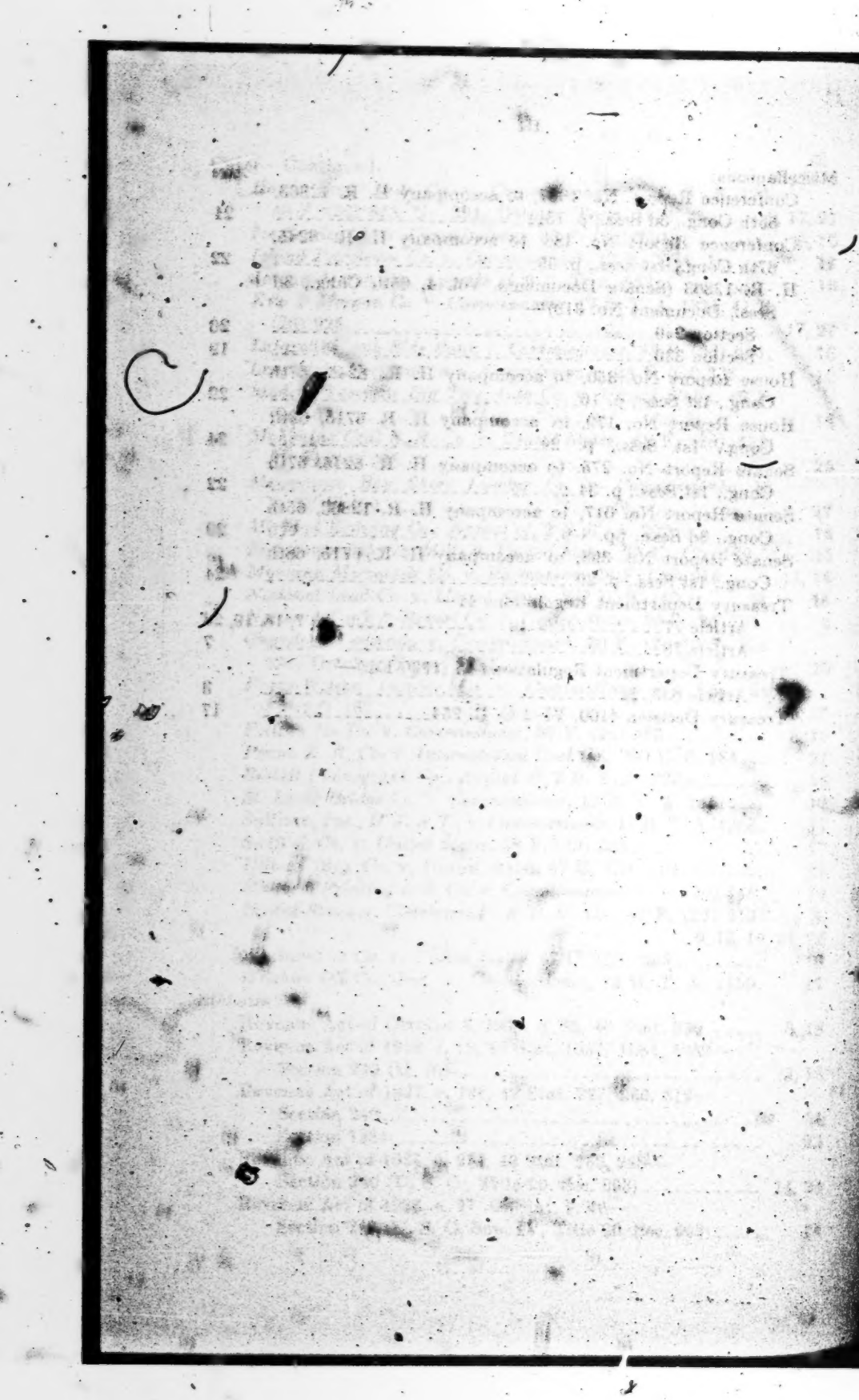
	Page
Opinions Below	1
Jurisdiction	1
Question Presented	2
Statute and Regulations Involved	2
Statement	3
Summary of Argument	5
Argument:	
"Substantially all" of the "stock" of the two corporations was neither "owned" nor "controlled" by "the same interests"	6
Conclusion	28

CITATIONS

Cases:	
Adolph Hirsch & Co. v. *Commissioner*, 7 B. T. A. 707	17
Alameda Investment Co. v. *McLaughlin*, 28 F. (2d) 81	8, 11
American Auto Trimming Co., Michigan, v. *Lucas*, 37 F. (2d) 80	8, 9, 12, 14, 16, 17
Brewster v. *Gage*, 280 U. S. 327	14
Burnet v. *Wilshire Oil Co.*, 46 F. (2d) 975	25, 26
Burnet v. *Bank of Italy*, 45 F. (2d) 629	8
Century Music Publishing Co. v. *Commissioner*, 12 B. T. A. 647	17
Commissioner v. *City Button Works*, 49 F. (2d) 705, No. 293, October Term, 1931	10, 15
Commissioner v. *Adolph Hirsch & Co.*, 30 F. (2d) 645	9, 10, 12, 15, 17
Commissioner v. *Richfield Oil Co.*, 42 F. (2d) 360	25, 26
Commissioner v. *Gong Bell Mfg. Co.*, 48 F. (2d) 205, No. 97, October Term, 1931	10
Commissioner v. *Crescent Leather Co.*, 40 F. (2d) 833	26
Conley Tin Foil Corporation v. *Commissioner*, 17 B. T. A. 65	17
Dunnuzio Fruit Co., Joe., v. *Commissioner*, 49 F. (2d) 41	8, 13
Dry Shoe Co. v. *United States*, 44 F. (2d) 273	27
Flannery & Co., J. Rogers, v. *Commissioner*, 42 F. (2d) 11, certiorari denied, 283 U. S. 839	25
Germantown Braid Co., Appeal of, 3 B. T. A. 1236	17
Goldstein Bros. Amusement Co. v. *Wallis*, 25 F. (2d) 787	13, 16
Great Lakes Hotel Co. v. *Commissioner*, 30 F. (2d) 1	25, 26, 27

Miscellaneous:

Conference Report No. 1027, to accompany H. R. [illegible], 66th Cong., 3d Sess., p. 25 24
Conference Report No. 656, to accompany H. R. [illegible], 67th Cong., 1st Sess., p. 23 24
H. R. 12863 (Senate Engrossed [illegible] Bill), Document No. [illegible], [illegible] Congress:
Section 240 23
Section 256 23
House Report No. [illegible], to accompany H. R. [illegible], 67th Cong., 1st Sess., p. 16 24
House Report No. 179, to accompany H. R. 6715, 68th Cong., 1st Sess., p. 24 24
Senate Report No. 275, to accompany H. R. [illegible], 67th Cong., 1st Sess., p. 24 24
Senate Report No. 617, to accompany H. R. [illegible], 66th Cong., 3d Sess., pp. 8-9 24
Senate Report No. 726, to accompany H. R. 6715, 68th Cong., 1st Sess., p. 26 24
Treasury Department Regulations 41—
Article 77 ..... 7, 12, [illegible]
Article 78 8
Treasury Department Regulations 45 (1920 Ed.)—
Article 632 8
Treasury Decision 4100, VI-2 C. B. 254 17



In the Supreme Court of the United States

OCTOBER TERM, 1931

No. 14

HANDY AND HARMAN, PETITIONER

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the United States Board of Tax Appeals (R. 21–24) is reported in 17 B. T. A. 980. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 46–49) is reported in 47 F. (2d) 184.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 12, 1931. (R. 49.) Petition for a writ of certiorari was filed February 5, 1931. Certiorari was granted March 16, 1931. (R. 50.)

Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether two companies may file a consolidated income-tax return as affiliated corporations under Section 240 of the Revenue Act of 1918 if the two companies are operating as a business unit and their stock is under the actual, but not legally enforceable, control of the same interests.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1081, 1082:

> SEC. 240. (a) That corporations which are affiliated within the meaning of this section shall, under regulations to be prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income and invested capital for the purposes of this title and Title III, and the taxes thereunder shall be computed and determined upon the basis of such return: * * *.
>
> (b) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (2) if substantially all the stock of two or more corporations is owned or controlled by the same interests.

Treasury Department Regulations 45 (1920 Edition):

ART. 633. *When corporations are affiliated.*—* * * The words "the same interests" shall be deemed to mean the same individual or partnership or the same individuals or partnerships, but when the stock of two or more corporations is owned or controlled by two or more individuals or by two or more partnerships a consolidated return is not required unless the percentage of stock held by each individual or each partnership is substantially the same in each of the affiliated corporations.

STATEMENT

Petitioner is a New York corporation engaged in the silversmithing business, its factory being located at Bridgeport, Connecticut. (R. 17.)

In December, 1916, the officers of the petitioner caused Hamilton & DeLoss, Inc., to be organized as a corporation under the laws of Connecticut to take over a department of the petitioner's business. Mr. Hamilton, a man experienced in silversmithing, became president of the new corporation. (R. 18.) He was without funds to purchase stock therein and DeLoss, vice president of petitioner (R. 18), made arrangements at a bank whereby Hamilton borrowed the money necessary to purchase 20% of the stock of Hamilton & DeLoss, Inc., upon his notes indorsed by DeLoss (R. 18–19, 36–37). The stock was issued to Hamilton (R. 19), who in turn ex-

stitted an "Irrevocable Stock Power" assigning such stock to Robert W. Higgins (R. 36-38), who in turn executed a similar instrument assigning the stock to DeLoss, who deposited it with the bank as collateral security for the payment of the notes (R. 37). Hamilton never paid anything on the notes. In 1919 he became insolvent and on February 1, 1919, DeLoss paid the notes and took over the stock. (R. 19, 37.) Prior to February 1, 1919, Hamilton attended all stockholders' meetings of Hamilton & DeLoss, Inc., and always voted his stock in harmony with the men who controlled both corporations. (R. 19.) He received a salary from Hamilton & DeLoss, Inc., but its other directors and officers, who were also directors, officers, or employees of petitioner, received their compensation from petitioner, even though all or a part of their working hours were devoted to Hamilton & DeLoss, Inc. (R. 19.)

During the taxable period in question Hamilton owned no stock in the petitioner, six men owned 93.71% of the capital stock of petitioner, and from 75.74% to 76.66% of the capital stock of Hamilton & DeLoss, Inc. Parties having no stock in Hamilton & DeLoss owned 6.29% of the stock of the petitioner. Others owning no stock of petitioner held from 3.83 to 3.34% of the stock of Hamilton & DeLoss, Inc. (R. 18.) They were close friends of DeLoss but took no active part in the business of Hamilton & DeLoss, Inc. Their stock was voted for them under proxies given to DeLoss. (R. 19.)

The Commissioner of Internal Revenue held that the petitioner and Hamilton & DeLoss were not entitled to file consolidated returns for the period preceding February 1, 1919 (R. 21), and his ruling was sustained by the Board of Tax Appeals (R. 21–24). On petition for review the Circuit Court of Appeals for the Second Circuit affirmed the order of the Board of Tax Appeals. (R. 29.) The question of affiliation of the two companies after February 1, 1919, when DeLoss took over Hamilton's stock, is not involved.

SUMMARY OF ARGUMENT

The only question here presented is whether "the same interests" owned or controlled "substantially all the stock" of the two companies. Hamilton, Blackburn, and Fones owned 24.26% to 23.34% of the stock of Hamilton & DeLoss, Inc., and no stock in the petitioner. The remaining 75.74% to 76.66% of the stock of Hamilton & DeLoss, Inc., did not constitute "substantially all" the stock of that company.

While the owners of the 24.26% to 23.34% of the stock of Hamilton & DeLoss at no time voted their stock in opposition to the principal stockholders of petitioner and acquiesced in the management of the two companies by the principal stockholders, never-

[illegible] control exercised by the principal stock-

[illegible] and the "control" [illegible] by the statute

[illegible] "control" required by the statute is a con-

[illegible] of the stock of the corporation and not a con-

trol of the business. It is a "control" based upon a legal right, exercised by one possessing a beneficial interest.

The principal stockholders of the petitioner exercised no such control over the stock of Hamilton & DeLoss, Inc., which they did not own. Neither did these principal stockholders and the holders of the 24.26% to 23.34% of the stock of Hamilton & DeLoss, Inc., constitute "the same interests" within the meaning of the statute, Article 633, Treasury Department Regulations 45, *supra*. Therefore "the same interests" neither owned nor controlled "substantially all" the stock of Hamilton & DeLoss, Inc., and hence affiliation was properly disallowed.

ARGUMENT

"SUBSTANTIALLY ALL" OF THE "STOCK" OF THE TWO CORPORATIONS WAS NEITHER "OWNED" NOR "CONTROLLED" BY "THE SAME INTERESTS"

In the administration of the war income and excess-profits tax provisions of the Revenue Act of October 3, 1917, c. 63, 40 Stat. 300, it was found that by creating subsidiaries and artificially apportioning thereto a part of its net profits a corporation could readily avoid much of the excess-profits taxes imposed upon income falling within the higher brackets. See *Pelican Ice Co.* v. *Commissioner*, 37 F. (2d) 285, 286. To correct this situation and enable the Commissioner to compute the amount of the tax properly due from each corporation on the basis of an equitable and lawful accounting, Article

77 and 78 of Treasury Department Regulations 41 were promulgated, requiring corporations, under certain circumstances, to file consolidated returns. (See Article 77, Regulations 41, p. 10.) The underlying purpose of Articles 77 and 78 was carried forward and incorporated in modified form in Section 240 of the Revenue Act of 1918, c. 18, 40 Stat. 1057. This section required corporations to file consolidated returns "(1) if one corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (2) if substantially all the stock of two or more corporations is owned or controlled by the same interests."

While this statute had for its primary purpose the benefit of the taxing power, in practice it has quite generally operated to the advantage of the taxpayers. (See cases, *infra*.) As a result there has been a constant effort on the part of corporations operated under a general business control to so extend the statute as to permit their filing a single joint return. Thus, in the instant case the petitioner and Hamilton & DeLoss filed consolidated returns of income for the taxable periods preceding February 11, 1919. (R. 21.) However, the Commissioner ruled that they were not entitled to file such consolidated returns. (R. 21.) This ruling was sustained by the Board of Tax Appeals (R. 33-34) and by the Circuit Court of Appeals for the Second Circuit (R. 49).

Under the provisions of Section 240 (b), *supra*, before two or more corporations are entitled to affiliation it must appear (1) that one corporation "owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others," or (2) that "substantially all the stock of two or more corporations is owned or controlled by the same interests."

The petitioner neither owned nor controlled any of the stock of Hamilton & DeLoss, Inc., and therefore it can not be said that the two corporations were affiliated under the first subdivision of Section 240 (b).

The second subdivision of Section 240 (b) prescribes three prerequisites to affiliation: (1) "the same interests" must (2) own or control (3) "substantially all the stock" of the two or more corporations. The stockholders of petitioner owned but 75.74% to 76.66% of the stock of Hamilton & DeLoss, Inc. It has been held that 85% (*Burnet v. Bank of Italy*, 46 F. (2d) 629, 630 (C. C. A. 9th)), 77 to 84% (*United States v. Cleveland, P. & E. R. Co.*, 42 F. (2d) 413, 419 (C. C. A. 6th)), 83⅓% (*Jos. Denunzio Fruit Co. v. Commissioner*, 49 F. (2d) 41 (C. C. A. 6th)), 80% (*Washburn & Co. v. United States*, 67 C. Cls. 235)), 75% (*American Auto Trimming Co., Michigan, v. Lucas*, 37 F. (2d) 801, 803 (App. D. C.), *Alameda Inv. Co. v. McLaughlin*,

28 F. (2d) 81 (N. D. Calif.)), and [illegible] (*National Tank & Export Co. v. United States*, 35 F. (2d) 331 (S. D. Ga.)), do not constitute "substantially all of the stock of a corporation." Clearly the 75.74% to 76.66% of the stock of Hamilton & DeLoss, Inc., standing in the names of stockholders of petitioner did not constitute "substantially all" the stock of Hamilton & DeLoss, Inc.

The question is therefore presented whether petitioner's stockholders "controlled" any of the stock of Hamilton & DeLoss, Inc., which they did not own. In considering this question it seems clear that the statute refers to stock control and not to control of the business. *Ice Service Co. v. Commissioner*, 39 F. (2d) 280, 281 (C. C. A. 2d); *Commissioner of Internal Revenue v. Adolph Hirsch & Co.*, 30 F. (2d) 645, 646 (C. C. A. 2d); *American Auto Trimming Co., Michigan, v. Lucas*, 37 F. (2d) 801, 803 (App. D. C.); *United States v. Cleveland, P. & E. R. Co.*, 42 F. (2d) 413, 419 (C. C. A. 6th). However, *Howes Bros. Hide Co. v. Commissioner*, 49 F. (2d) 878 (C. C. A. 1st), holds that general business control is enough. Petition for certiorari has been filed by the Commissioner, No. 294, October Term, 1931.

Blackburn and Foner, owning from 3.83 to 3.84% of the stock of Hamilton & DeLoss, Inc. (R. 18), were close friends of DeLoss, who voted their stock by proxies (R. 19). Hamilton, owning 20% of the

stock of Hamilton & DeLoss, Inc.,[1] attended all meetings of the stockholders and voted his stock, but never in opposition to the principal stockholders of petitioner. (R. 19.) But a domination by majority stockholders resting only upon an acquiescence which they had the good fortune to induce without the right to demand is not the "control" of stock contemplated by the statute.

The court below held that the control contemplated by the statute "must at least be a control legally enforceable" (R. 48), thus following its former holdings in *Commissioner of Internal Revenue* v. *Adolph Hirsch & Co.*, 30 F. (2d) 645, 646, and *Ice Service Co.* v. *Commissioner*, 30 F. (2d) 230, 231, to which it has subsequently adhered *Commissioner* v. *Gong Bell Mfg. Co.*, 48 F. (2d) 205, 206 (petition for certiorari pending, No. 97, October Term, 1931, consideration withheld pending decision in the instant case); *Commissioner* v. *City Button Works*, 49 F. (2d) 705, 706 (petition for certiorari pending, No. 293, October Term, 1931); *The Onondaga Company* v. *Commissioner*, 50 F. (2d) 337 (petition for certiorari has been filed in this case, No. 320, October Term, 1931).

---

[1] While Hamilton assigned his stock to DeLoss as security for his bank's endorsement of Hamilton's notes, DeLoss in turn pledged the stock with the bank. (R. 36-38, 46.) The [illegible] and control of the stock either remained in Hamilton (*Lancaster Corporation* v. *Commissioner*, [illegible] C. C. A. 6th) or [illegible] (*Falcon Ice Co.* v. *Commissioner*, 37 F. (2d) 235, 236 C. C. A. 5th), or were transferred to the bank. The majority stockholders [illegible] control over the bank.

The meaning to be attributed to the word "control" or "controlled" has been many times before the courts. In *Alameda Investment Co. v. McLaughlin*, 28 F. (2d) 81, Judge Bourquin, sitting in the District Court for the Northern District of California, considered the meaning to be attached to the word "control" or "controlled." He said (p. 82):

> And managerial authority of [illegible] president of plaintiffs [illegible] plaintiffs no beneficial interest in the other 25 per cent of Alameda stock, nor hazard, no liability in respect to taxes affecting its owner. Hence, was not that "control" of said 25 per cent of Alameda which the statute contemplated, nor within the statute were plaintiffs affiliated. If this be not correct, then several corporations, without mutuality of interest, save a common agent or manager, could claim the benefit of the statute.

And again, in *Montana Mercantile Co. et al. v. Rasmusson*, 28 F. (2d) 216 (Mont.), he said:

> But it is by plaintiffs contended that various shares of the Western stock, not owned by the Montana shareholders, were owned by relatives and friends of the former, and that the Montana management "dictated" the policy of the Western. Even so, this is not the "control" contemplated by section 240 of the Revenue Acts (1918, 40 Stat. 1081; 1921, 42 Stat. 260), by virtue of which the corporations are "affiliated" within the statute, and entitled to consolidated in-

come-tax returns with corresponding advantages in lessened taxes.

The control by the statutes contemplated is that which gives rise to beneficial interest, and not mere exercise of authority, whether legal or illegal, granted or seized, not that permitted by reason of friendliness or relationship (of "their sisters and their cousins and their aunts"), or the activity or neglect and violation of duty of the boards of directors.

These views of Judge Bourqin were approved by the Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *Adolph Hirsch & Co.*, 30 F. (2d) 645, 646, wherein it was said:

The management of the business of the corporation is not the control required by the statute. It refers to stock control. The fact that the minority is acquiescent, and permits the majority to manage the business, does not prove actual control over the minority interest. Nor does a control based upon friendship or professional relations satisfy the statute. The control of the stock owned by the same interests refers to beneficial interest.

This statement was quoted with approval by the Court of Appeals of the District of Columbia in *American Auto Trimming Co., Michigan*, v. *Lucas*, 87 F. (2d), 801, 803, where the court concluded:

That no officer or employee attempted to oppose the will of Benjamin Godfredson in the management of the companies is not controlling.

In *United States* v. *Cleveland, P. & E. R. Co.*, 42 F. (2d) 413, the Circuit Court of Appeals for the Sixth Circuit, after extensively reviewing the history of affiliation legislation and the decisions rendered thereunder, said (p. 419):

> While the grant of proxies by some and the failure by others to vote at the annual meetings might be deemed an acquiescence in defendant's *economic control* of the Ashtabula Company, that, in our judgment, and under the great weight of the decisions, does not suffice for affiliation.

A similar view was expressed in *Goldstein Bros. Amusement Co.* v. *White*, 32 F. (2d) 287 (Mass.). See *Jos. Denunzio Fruit Co.* v. *Commissioner*, 49 F. (2d) 41 (C. C. A. 6th); *Madera Yosemite Big Tree Auto Co.* v. *United States*, 49 F. (2d) 672, 678 (C. Cls.).

It is submitted that the "control" necessary to satisfy the statute must be a control of the stock as distinguished from a control of the business and that such control must be based upon a legal right exercised by one possessing a beneficial interest in such stock. It is obvious that the stockholders of petitioner exercised no such control over the stock which they did not themselves own. It follows that unless it may be said that Hamilton (owning 20% of the stock of Hamilton & DeLoss, Inc.) and the majority stockholders of petitioner constituted "the same interests," the petitioner and

Hamilton & DeLoss, Inc., were not entitled to affiliation.

Article 633 of Treasury Department Regulations 45, *supra*, defines "the same interests" as meaning "the same individual or partnership or the same individuals or partnerships." This article further provides:

> * * * but when the stock of two or more corporations is owned or controlled by two or more individuals or by two or more partnerships a consolidated return is not required unless the percentage of stock held by each individual or each partnership is substantially the same in each of the affiliated corporations.

Congress continued to use the term "the same interests" in Section 240 (c) of the Revenue Acts of 1921, 1924, and 1926 (c. 136, 42 Stat. 227; c. 234, 43 Stat. 253, U. S. C., Title 26, Sec. 993; c. 27, 44 Stat. 9, U. S. C. Sup. IV, Title 26, Sec. 993), and it will be presumed, therefore, that the administrative interpretation of the meaning of the phrase met with Congressional approval. *National Lead Co.* v. *United States*, 252 U. S. 140, 146–147; *Brewster* v. *Gage*, 280 U. S. 327, 336; *American Auto Trimming Co., Michigan*, v. *Lucas*, 37 F. (2d) 801, 803 (App. D. C.); *Uniform Printing & S. Co.* v. *Commissioner*, 33 F. (2d) 445, 447 (App.

While the meaning of the phrase "the same interests" is not necessarily involved, it is submitted that a careful analysis of the decisions cited by petitioner, and the legislative history of Section 240 (see pp. 18 to 25, *infra*), makes it necessary that the meaning of this phrase be considered.

D. C.); *Commissioner* v. *City Button Works*, 49 F. (2d) 705, 706 (C. C. A. 2d). (Petition for certiorari has been filed in the latter case, No. 293, October Term, 1931.) This administrative interpretation, presumptively approved by Congress, was clearly justified. It was approved in *Lafayette-South Side Bank* v. *Commissioner*, 33 F. (2d) 646, 647–648 (App. D. C.); and by the Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *Adolph Hirsch & Co.*, 30 F. (2d) 645, wherein it was said (p. 646):

> Stockholders of two or more corporations, if the same persons, and their holdings in different corporations are in the same proportion, bear the ultimate burden of taxes equally and equitably, regardless of whether it rests primarily upon one or the other of the affiliated corporations, if only such corporations be deemed affiliated, but it is where the proportions of the stockholders are different that inequities result. * * * These stockholders would suffer disadvantages and might receive benefits through the operations of the respondent, in which they have no interest or representation. Thus there is no fair basis of affiliation of ownership, and there is no control of substantially all of the stock by the same interests.

And in *Commissioner* v. *City Button Works*, *supra*, the same court again sustained the regulations, saying (p. 706):

> However that may be, when as here the distribution is unequal, it appears to us that the

section does not apply, for it is not enough that the gross income of each company goes to the same persons. That condition would be fulfilled in a case where half the shareholders held ninety per cent of the shares in one company and ten per cent in the other, and the other half, vice versa. It would be a forced construction which should regard such a pair as a single "business unit"; the phrase used in the Senate Committee report upon the section. Not only would the management of each company be in a different group but the interest of each majority in the respective incomes would be different. On neither score would it be in accord with general notions to think of the two companies as one.

For this reason the regulations under the Act of 1918 (article 633, Regulations 45) provided that the holdings must be substantially in the same proportions in each company, and the same was repeated under the Act of 1921 (article [illegible]3, Regulations 62). The enactment of the second statute was a legislative recognition of this regulation.

To the same effect see *American Auto Trimming Co., Michigan*, v. *Lucas*, 37 F. (2d) 801, 803 (App. D. C.); *Goldstein Bros. Amusement Co.* v. *White*, 33 F. (2d) 787, 788 (Mass.); *Montana Mercantile Co.* v. *Rasmusson*, 28 F. (2d) 916 (Mont.).[1]

[1] The Board of Tax Appeals refused to follow the administrative interpretation of the meaning of the phrase "the same interests" (see *Appeal of Rishell Phonograph Co.*, 2 B. T. A. 229, 233; *Appeal of Midland Refining Co.*, 2 B. T. A. 293, 296; *Appeals of Jordan Marsh Co. et al.*, 3 B. T. A.

It would seem, therefore, that there may be included in "the same interests" only those stockholders who held stock in each of the two corporations in substantially the same proportions. Since Hamilton, Blackburn, and Fones owned no stock in petitioner it is obvious that only the stockholders of petitioner holding the 75.74 to 76.66% of the stock of Hamilton & DeLoss, Inc., may, in any event, be

---

556, 557; *Appeal of Germantown Braid Co.*, 3 B. T. A. 1336; *Adolph Hirsch & Co.* v. *Commissioner*, 7 B. T. A. 707, 711; *Century Music Publishing Co.* v. *Commissioner*, 12 B. T. A. 647, 651; *Wilshire Oil Co., Inc.*, v. *Commissioner*, 13 B. T. A. 1150, 1153–1154); with the result that affiliation was allowed under the Board's interpretation of the meaning of the phrase "the same interests," but the Commissioner could not compel affiliation under the Board's interpretation of the statute by reason of his regulations. Therefore, on November 12, 1927, the regulations were amended by deleting the above definition from Treasury Regulations 45, T. D. 4100, VI–2 C. B. 254. However, since the administrative interpretation had by that time been presumptively approved by Congress the Commissioner was without power to change the law and the attempted amendment had no retroactive force. *Swift & Co.* v. *United States*, 38 F. (2d) 365, 373 (C. Cls.). Since judicial approval of the administrative interpretation by the Commissioner was obtained in *Commissioner* v. *Adolph Hirsch & Co.*, 30 F. (2d) 645, both the Commissioner and the Board of Tax Appeals have consistently applied the original administrative interpretation of the statute. See *Island Petroleum Co.* v. *Commissioner*, 17 B. T. A. 1, 10; *Conley Tin Foil Corporation* v. *Commissioner*, 17 B. T. A. 65, 71–72; *Howes Brothers Hide Co. et al.* v. *Commissioner*, 17 B. T. A. 129, 134–135; *St. Louis Bridge Co. et al.* v. *Commissioner*, 17 B. T. A. 185, 194; *D. J. & T. Sullivan, Inc.*, v. *Commissioner*, 17 B. T. A. 1359, 1360; *Kile & Morgan* v. *Commissioner*, 17 B. T. A. 1371, 1375; *Mammoth Bay Shore Lumber Co.* v. *Commissioner*, 18 B. T. A. 499, 502–503.

regarded as "the same interests," and since these stockholders neither owned nor controlled "substantially all the stock" of Hamilton & DeLoss, Inc., it follows that the Board of Tax Appeals and the Circuit Court of Appeals properly held that the two companies were not entitled to affiliation.

The legislative history of Section 240 (b) of the Revenue Act of 1918 clearly supports the above interpretation of the meaning to be given to the word "control" and the phrase "the same interests" as used therein. Consolidated returns were first required by Article 77 of Treasury Department Regulations 41, promulgated under the War Revenue Act of October 3, 1917, c. 63, 40 Stat. 300. This article provided:

> For the purpose of this regulation two or more corporations will be deemed to be affiliated (1) when one such corporation owns directly or controls through closely affiliated interests or by a nominee or nominees, all or substantially all of the stock of the other or others, or when substantially all of the stock of two or more corporations is owned by the same individual or partnership, and both or all of such corporations are engaged in the same or a closely related business; or (2) when one such corporation (a) buys from or sells to another products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or (b) in any way so arranges its financial

relationships with another corporation as to assign to it a disproportionate share of net income or invested capital.

It will be observed that that part of this regulation covered by subdivision (1) corresponds very closely to Section 240 (b) as incorporated in the Revenue Act of 1918, while subdivision (2) provided for affiliation where two or more companies were operated as an economic or business unit under a general business control. See *United States* v. *Cleveland, P. & E. R. Co.*, 42 F. (2d) 413, 419 (C. C. A. 6th).

When H. R. 12863, which became the Revenue Act of 1918, was first passed by the House of Representatives Section 336 thereof provided (Senate Documents, Vol. 4, 65th Congress, 3d Session, Document 310, p. 107):

> In no case shall the tax under this title [Excess Profits Tax] or Title II [Income Tax] be determined on the basis of a so-called consolidated return but shall in each case be determined upon the basis of the net income and invested capital of the corporation liable to the tax.

The Senate Finance Committee, however, thought it desirable that Article 77 of Treasury Regulations 41 be incorporated in the Bill. It therefore struck out Section 336, *supra*, and incorporated the provisions of Article 77 of Regulations 41 in Section 240. (H. R. 12863, Senate Documents, Vol. 4, 65th Congress, 3d Session, Document No. 310, p. 88.) In making its report to the Senate the Committee said

(Senate Report No. 617, to accompany H. R. 12863, 65th Congress, 3d Session, pp. 8–9):

CONSOLIDATED RETURNS

Provision has been made in section 240 for a consolidated return, in the case of affiliated corporations, for purposes both of income and profits taxes. * * *

* * * * * * *

While the committee is convinced that the consolidated return tends to conserve, not to reduce, the revenue, the committee recommends its adoption not primarily because it operates to prevent evasion of taxes or because of its effect upon the revenue, but because *the principle of taxing as a business unit what in reality is a business unit is sound and equitable and convenient both to the taxpayer and to the Government.* (Italics ours.)

Acting upon the Committee's recommendation the Senate passed the Bill as amended. Section 240 (b) of the Bill then provided (Senate Documents, Vol. 4, H. R. 12863, Document No. 310, 65th Congress, 3d Session, pp. 65–66):

SEC. 240. (b) For the purpose of this section, two or more corporations shall be deemed to be affiliated—

(1) If one corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or if substantially all the stock of two or more cor-

> porations is owned or controlled by the same interests, or if one such corporation buys from or sells to another products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or in any way so arranges its financial relationships with another corporation as to assign to it a disproportionate share of net income or invested capital.
>
> * * * * * *

In conference the provision relating to the economic unit or general business control theory of affiliation corresponding to subdivision (2) of Article 77, Regulations 41, was stricken out (See H. R. Conference Report No. 1037, p. 15, 65th Congress, 3d Session, to accompany H. R. 12863), and the Act finally emerged without those provisions being included as grounds for affiliation.

In *United States v. Cleveland, P. & E. R. Co.*, *supra*, in considering the effect to be given to the action of Congress in deleting the above provisions from Section 240 (b) of the Revenue Act of 1918 the court said (p. 416):

> In summary it may be seen from this history of section 240 (b) that, although Congress [the Senate] obviously attempted to adopt the existing Treasury practice which considered as affiliated any group of corporations engaged in similar businesses and operated as an economic unit, the statute which finally emerged from the legislative mill predicated affiliation entirely upon *stock ownership or control*. Much of the dif-

Easily in reconciling the conflicting interventions of the section may be attributed to judicial endeavors to effectuate this unexpressed purpose by reading it into the loose terminology of *ownership and control* or by stretching the phrase "same interests."

When H. R. 8245, which later became the Revenue Act of 1921, c. 136, 42 Stat. 227, was before the House it appears that the validity of Article 77 of Treasury Regulations 41 as affecting 1917 taxes had been brought into question. For that reason Section 1007 of the Bill as reported out of Committee provided for its retroactive validation. (Committee on Ways & Means, House Report No. 350, to accompany H. R. 8245, 67th Congress, 1st Sess., p. 16.) When the Bill reached the Senate Section 1007 was eliminated and Section 1331 was inserted. (Senate Committee on Finance, Report No. 275, to accompany H. R. 8245, 67th Congress, 1st Sess., p. 34; Conference Report No. 486, to accompany H. R. 8245, 67th Congress, 1st Sess. p. 59.) As the Bill finally emerged instead of making subdivision

---

Revenue Act of 1921, c. 136, 42 Stat. 227, 319:

SEC. 1331. (a) That Title II of the Revenue Act of 1917 shall be construed to impose the taxes therein mentioned upon the basis of consolidated returns of net income and invested capital in the case of domestic corporations and domestic partnerships that were affiliated during the calendar year [illegible]

For the purpose of this section a corporation or partnership is affiliated with one or more corporations or partnerships when such corporation or partnership is directly or indirectly connected through closely affiliated interests by a common ownership of substantially all the

(2) of Article 77 of Treasury Regulations [illegible] additional separate ground for [illegible] required that the corporations be [illegible] consolidate unit as a condition precedent [illegible] under subdivision (1). *Montgomery Cotton Mills v. United States*, 67 C. Cls. 169, 171.

When H. R. 6715, which later became the Revenue Act of 1924, c. 234, 43 Stat. 253, was before the House Committee on Ways and Means that Committee was apparently advised of the tendency of the taxpayers and the courts to defeat the limitations intended to be prescribed in Section

---

stock of the other or others, or (2) when substantially all the stock of two or more corporations or the business of two or more partnerships was owned by the same interests: *Provided*, That such corporations or partnerships were engaged in the same or a closely related business, or that corporation or partnership bought from or sold to another corporation or partnership products or services at prices above or below the current market, thus affecting an artificial distribution of profits, or that corporation or partnership in any way so arranged its financial relationships with another corporation or partnership as possibly to lift a disproportionate share of net income or invested capital. For the purpose of this section, public service corporations which (1) were operated independently, (2) were not physically connected or merged and (3) did not receive a part [illegible] to make a consolidated return, shall not be considered to be affiliated additionally by a contract or other public utility which was owned by an industrial corporation and [illegible] operated as a plant facility or as an integral part of a group organization of affiliated corporations which were required to file a consolidated return, shall be considered to have been affiliated.

[illegible] provisions of this section are declaratory of the [illegible] of the Revenue Act of 1917."

240 of the Revenue Acts of 1918 and 1921. Accordingly, in reporting the Bill to the House the Committee with relation to Section 240 said (House Report No. 179, to accompany H. R. 6715, 68th Congress, 1st Session, p. 24):

> Subdivision (e) is amended to provide that two or more corporations shall be deemed to be affiliated if one corporation *owns* at least 85 per cent of the voting stock of the others or if at least 85 per cent of the voting stock of two or more corporations is *owned* by the same interests. *This language is substituted for the indefinite and vague language of the existing law.* * * * (Italics ours.)

When the Bill reached the Committee on Finance of the Senate the percentage of stockholdings was raised to 95. In explaining the elimination of the word "control" from the statute the Committee in reporting to the Senate repeated what the House Committee had said with relation to the "indefinite and vague language of the existing law." (Senate Report No. 398, to accompany H. R. 6715, 68th Congress, 1st Session, p. 29.) The recommendation of the House Committee as amended by the Senate was ultimately incorporated in Section 240 (c) of the Revenue Act of 1924 and the word "control" was eliminated from the statute.[1]

---

[1] Revenue Act of 1924, c. 234, 43 Stat. 253, 288:

"SEC. 240. (c) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns at least 95 per centum of the voting

It thus appears that Congress has on several occasions definitely refused to sponsor the theory that affiliation should be allowed or required where two or more corporations were operated merely as an economic unit under a general business control.

Congress having rejected this theory of affiliation, the courts may not so interpret the statute as to add thereto the rejected provision. But that is exactly what some of the courts have attempted to do. Thus in *J. Rogers Flannery & Co.* v. *Commissioner*, 42 F. (2d) 11, 12 (C. C. A. 3d), certiorari denied, 282 U. S. 889, the court quoted from Senate Report No. 617, *supra*, and then proceeded to read the report into the statute although the provision relating to the business or economic unit theory of affiliation was rejected in conference and never became a part of the law. In *Mahoning Coal R. Co.* v. *United States*, 41 F. (2d) 533, 535–536 (N. D. Ohio), reversed, 51 F. (2d) 208 (C. C. A. 6th), the District Court similarly attempted to read Senate Finance Report No. 617 into Section 240 (b) of the Revenue Acts of 1918 and 1921.

Other courts have sponsored the business or economic unit theory of affiliation. *Great Lakes Hotel Co.* v. *Commissioner*, 30 F. (2d) 1, 4 (C. C. A. 7th); *Commissioner* v. *Richfield Oil Co.*, 42 F. (2d) 360, 362 (C. C. A. 9th); *Burnet* v. *Wilshire Oil Co.*, 46 F. (2d) 975 (C. C. A. 9th); *Peavy-Wilson Lumber Co.* v. *Commissioner Int. Rev.*, 51 F. (2d) 163 (C. C.

---

stock of the other or others, or (2) if at least 95 per centum of the voting stock of two or more corporations is owned by the same interests. * * *." (U. S. C., Title 26, Sec. 998.)

A. 5th); *Ullman Mfg. Co.* v. *United States*, 67 C. Cls. 104, 111.

This end has been accomplished by reading "into the loose dichotomy of *ownership* and *control*" that which Congress intentionally excluded, or "by stretching the phrase 'same interests.'" *United States* v. *Cleveland, P. & E. R. Co.*, *supra*, p. 416. Thus it has been held that a "control" based upon "ownership, contract, and *otherwise*" (italics ours), (*Commissioner* v. *Crescent Leather Co.*, 40 F. (2d) 833, 835 (C. C. A. 1st); fear of employee stockholder that opposition to majority might result in loss of position (*Commissioner* v. *Richfield Oil Co.* (C. C. A. 9th), *supra*, pp. 361-362); right to discharge an employee who had agreed that "in the event his connection with said company should be severed he would sell said stock to the plaintiff at a reasonable price" (*Ullman Mfg. Co.* v. *United States* (C. Cls.), *supra*, p. 109); "an understanding that if any minority stockholder wished to sell his stock, it should first be offered for sale to" a majority stockholder, and "as a matter of practice such minority stockholders offered their stock" to the majority stockholder which offers were always accepted, together with a practice of the minority stockholders giving proxies to the majority stockholder (*Great Lakes Hotel Co.* v. *Commissioner*, 30 F. (2d) 1, 4 (C. C. A. 7th)); acquiescence of business associates (*Burnet* v. *Wilshire Oil Co.* (C. C. A. 9th), *supra*); acquiescence of members of families, employees, and other minority stock-

holders, and right to call preferred voting stock for redemption on 90 days' notice (*Hoover Bros. Hide Co.* v. *Commissioner*, 49 F. (2d) 878 (C. C. A. 1st), petition for certiorari filed by the Commissioner, No. 294, October Term, 1931); or acquiescence of members of families, employees, business associates and friendly banks (*Peavy-Wilson Lumber Co.* v. *Commissioner* (C. C. A. 5th), *supra*); satisfied the requirements of the statute; and that there may be included in "the same interests" members of the same family regardless of their respective holdings (*Kile & Morgan Co.* v. *Commissioner*, 41 F. (2d) 925 (C. C. A. 1st); *Eby Shoe Co.* v. *United States*, 44 F. (2d) 273, 277 (C. Cls)), and majority stockholders in each of six corporations being "guided in their action by a common intent" where their common object was to be attained "by all corporations pursuing the same methods through the same agencies" (*Great Lakes Hotel Co.* v. *Commissioner*, *supra*, p. 4).

Thus it will be seen that by reading into the Act the substance of Senate Finance Committee Report No. 617, *supra*, some of the courts have, in effect, incorporated into the statute a provision which was clearly rejected by Congress. Obviously this may not be done. In *Penna. R. R. Co.* v. *International Coal Co.*, 230 U. S. 184, 198-199, this Court had a similar situation before it. There it said:

> The fact that this provision measuring the amount of recovery by rebate was omitted from the Act, as finally reported to both Houses and passed, is not only significant,

but so conclusive against the contention of the plaintiff that it quotes—not the report of the conference committee—but a statement, made by a member of the Senate Conference Committee, to support the present argument that § 8 means the same thing as the omitted clause. But while they may be looked at to explain doubtful expressions, not even formal reports—much less the language of a member of a Committee—can be resorted to for the purpose of construing a statute contrary to its plain terms, or to make identical that which is radically different.

This states substantially the vice of petitioner's argument based upon the Senate committee's comments on the original bill passed by the Senate. The business or economic theory of affiliation was rejected by Congress and those decisions, cited by petitioner, which have adopted the theory discarded by Congress are clearly wrong.

CONCLUSION

We respectfully submit that the decision of the court below should be affirmed.

THOMAS D. THACHER,
Solicitor General.
G. A. YOUNGQUIST,
Assistant Attorney General.
WHITNEY NORTH SEYMOUR,
SEWALL KEY,
JOHN H. MCEVERS,
Special Assistants to the Attorney General.

OCTOBER, 1931.